



Prepared by
The
Department of
Finance

CALIFORNIA **Governor's Budget**



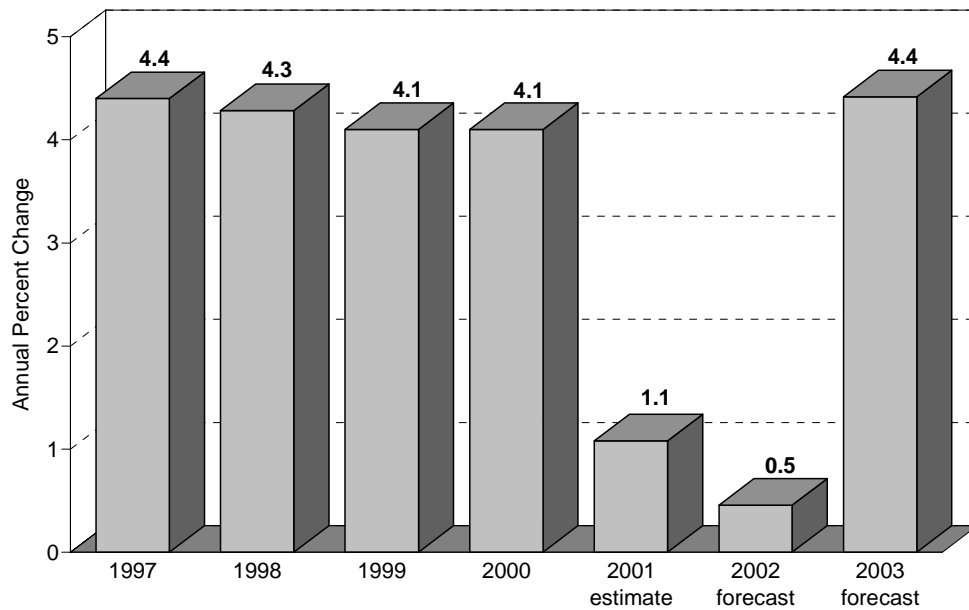
2002-03

Joint Hearing of
Senate Budget & Fiscal Review Committee and
Assembly Budget Committee

—
January 2002

Economic Outlook

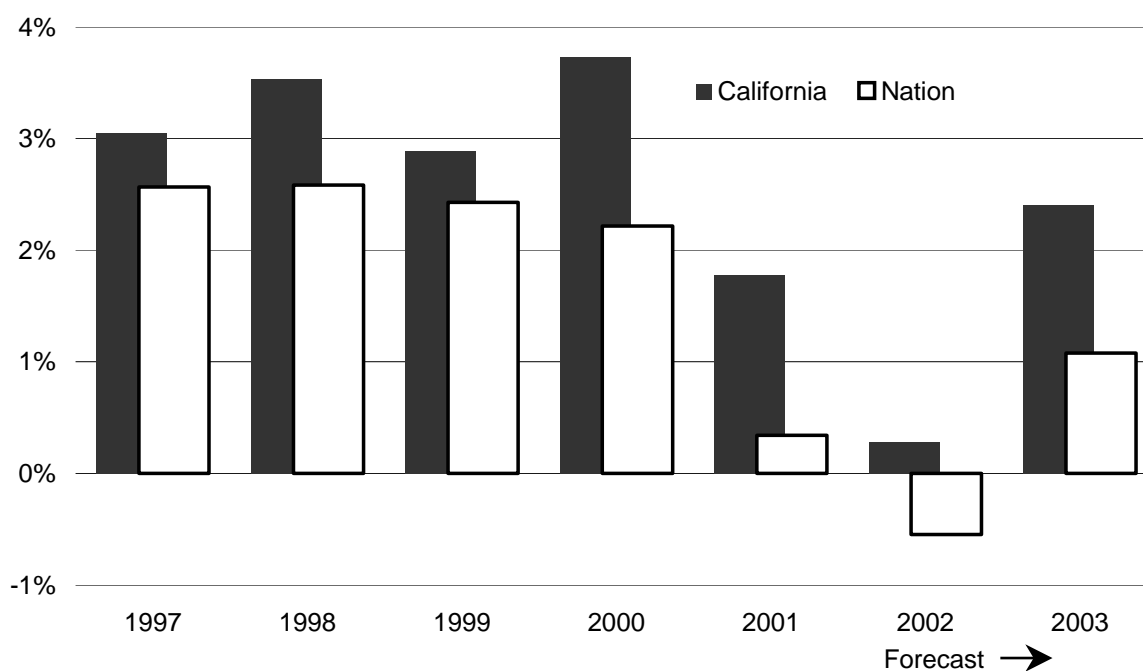
Growth in Real Gross Domestic Product



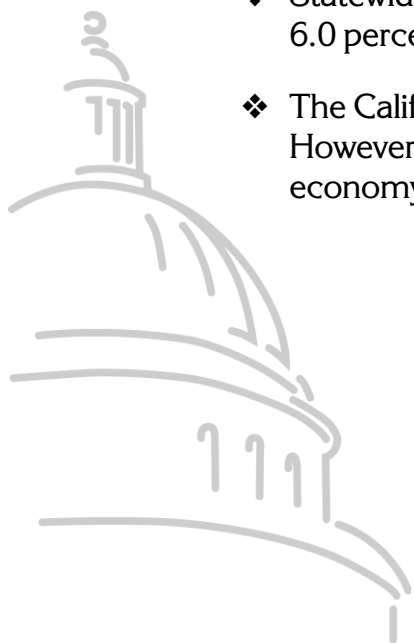
- ❖ The national and California economies slowed in 2001, with the national economy slipping into recession in March.
- ❖ Tax cuts, increased federal government spending, and easier monetary policy will help bring about a rebound in the growth of both economies by midyear 2002.



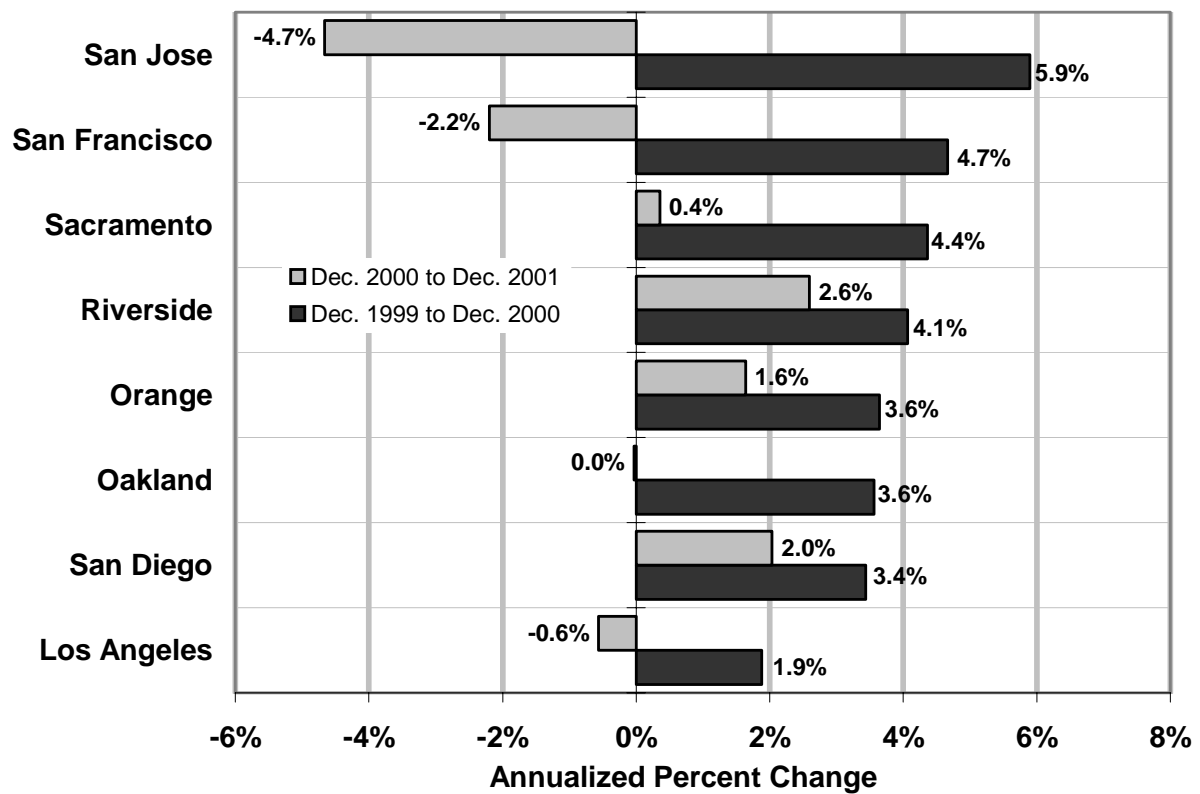
Nonfarm Payroll Employment Annual Average Percent Growth

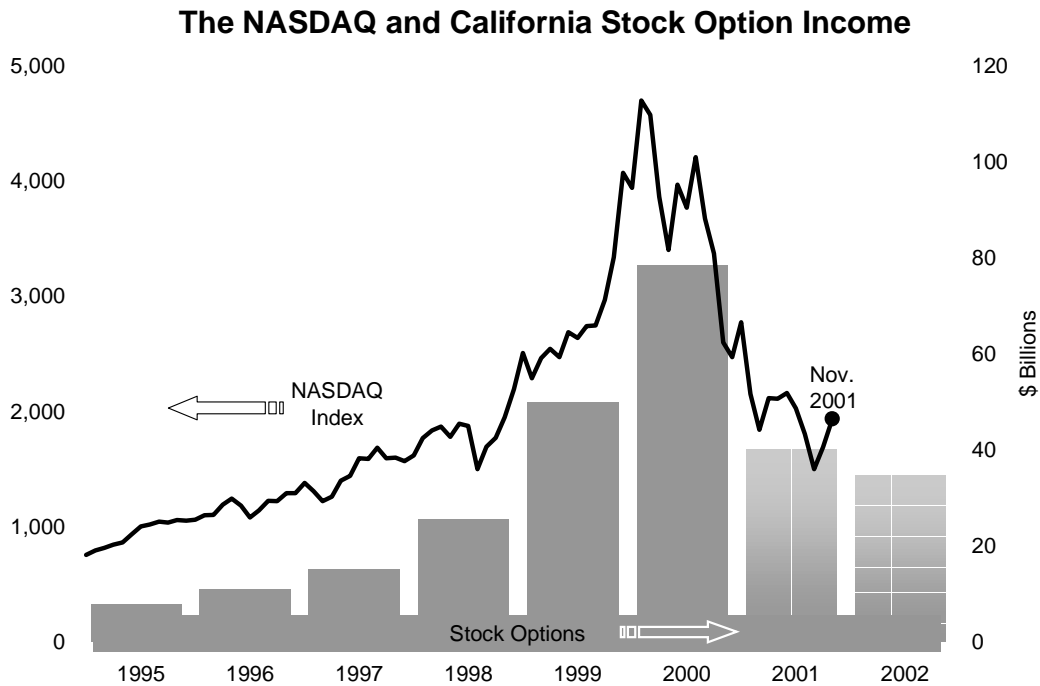


- ❖ Although faring better than the rest of the nation, job growth fell to 1.8 percent in 2001 from 3.7 percent in 2000.
- ❖ Statewide unemployment rose through most of the year, reaching 6.0 percent in November.
- ❖ The California economy should begin to grow by midyear 2002. However, unemployment will continue to rise even after the economy continues to grow, averaging 6.2 percent in 2002.

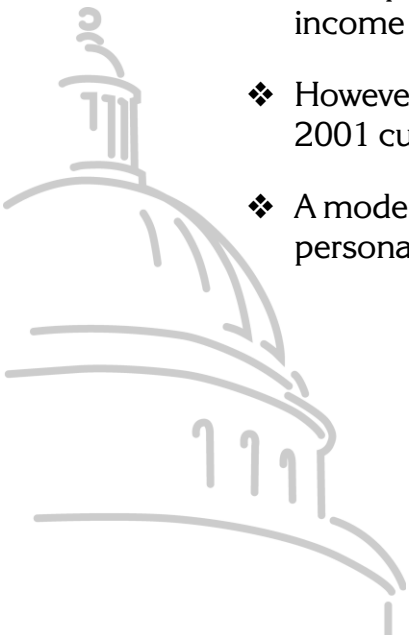


Employment Growth: Eight Largest Metro Areas



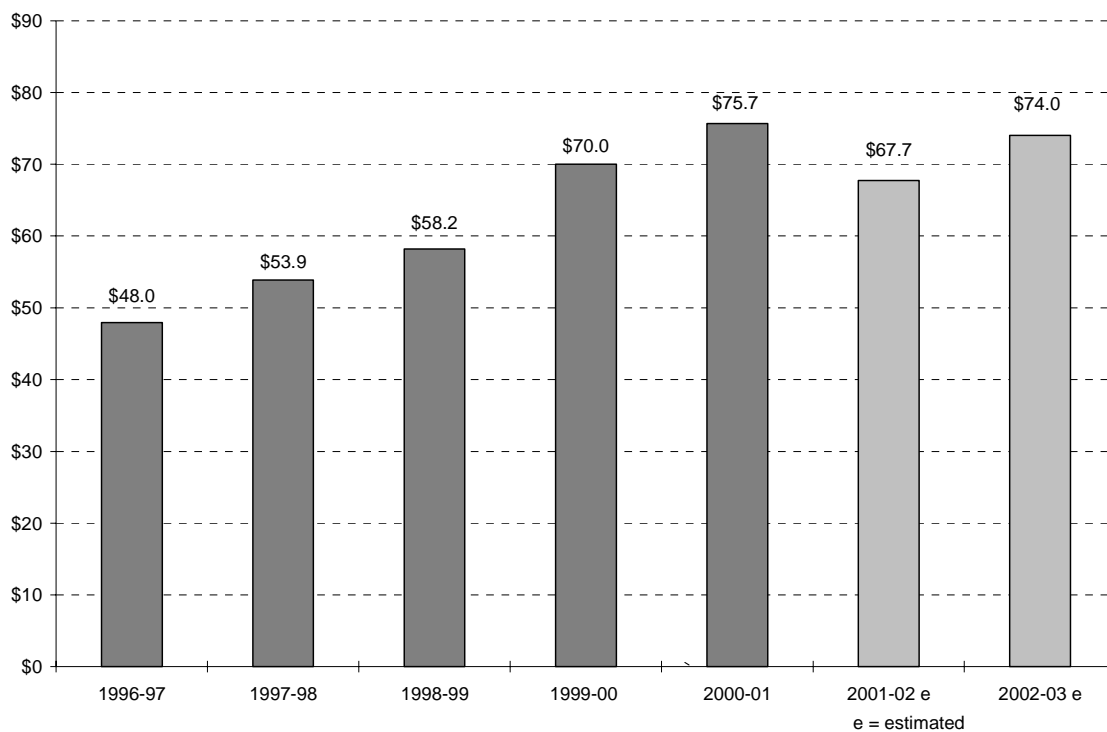


- ❖ After growing almost 10 percent in 2000, California personal income grew only 1.4 percent in 2001.
- ❖ Stock prices soared between 1995 and 2000, with stock option income giving a huge boost to California personal income.
- ❖ However, the deep descent in stock prices beginning in March 2001 cut stock option income almost in half in 2001.
- ❖ A moderate rebound in the stock market should help California personal income grow by 2.6 percent in 2002.

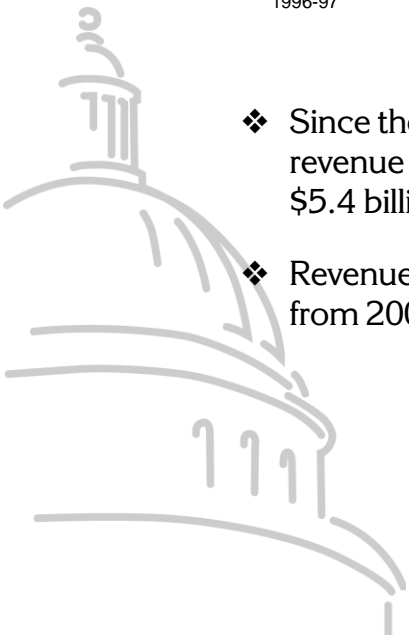


Revenue Estimates

Major General Fund Taxes and Licenses (Dollars in Billions)



- ❖ Since the enactment of the 2001 Budget Act, the General Fund revenue forecast for major revenues and licenses has decreased \$5.4 billion for the past and current year combined.
- ❖ Revenue growth should resume in 2002-03 and be up \$6.3 billion from 2001-02, reaching \$74.0 billion.



Major Revenue Sources

- ❖ Personal income tax revenues are projected to be \$38.5 billion in 2001-02 and \$42.6 billion in 2002-03.
- ❖ Sales and use tax revenue is forecast at \$21.2 billion in 2001-02 and \$22.9 billion in 2002-03.
- ❖ Corporation tax revenues are expected to total \$5.3 billion in 2001-02 and \$5.9 billion in 2002-03.



Comparison of Legislative Analyst (LAO) and Department of Finance (DOF) Capital Gains and Stock Options Estimates

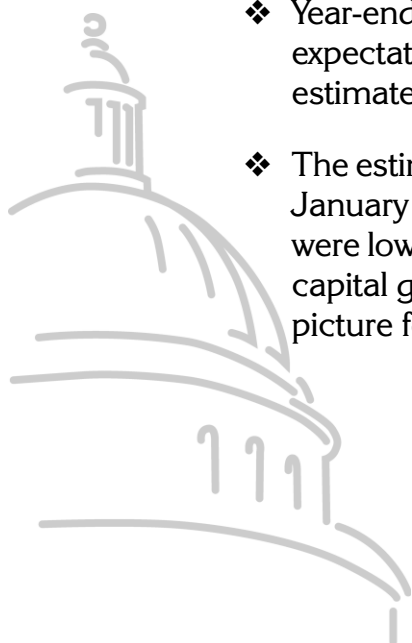
LAO Capital Gains and Stock Options: November 2001 (Dollars in Millions)

	<u>CapGains</u>	<u>% Change</u>	<u>Options</u>	<u>% Change</u>	<u>Combined</u>	<u>% Change</u>
1999	94.1		70.0		164.1	
2000	120.4	27.9%	85.0	21.4%	205.4	25.2%
2001	60.2	-50.0%	21.3	-74.9%	81.5	-60.3%
2002	69.3	15.1%	24.4	14.6%	93.7	12.0%

DOF Capital Gains and Stock Options: December 2001 (Dollars in Millions)

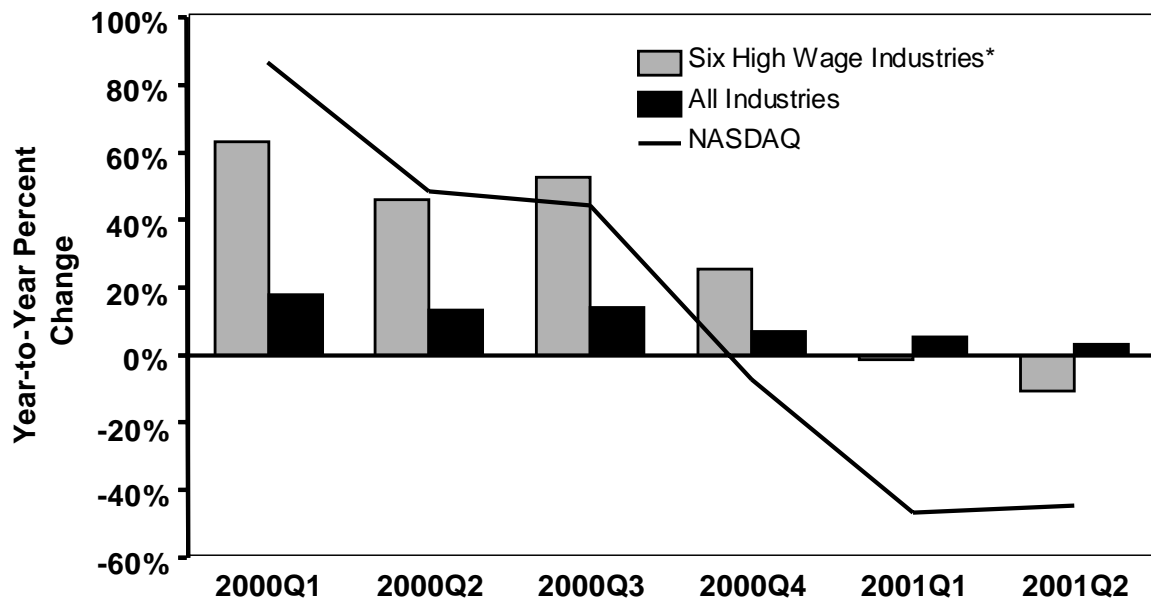
	<u>CapGains</u>	<u>% Change</u>	<u>Options</u>	<u>% Change</u>	<u>Combined</u>	<u>% Change</u>
1999	91.0		50.0		141.0	
2000	118.3	30.0%	78.5	57.0%	196.8	39.6%
2001	65.1	-45.0%	40.1	-48.9%	105.2	-46.6%
2002	73.2	12.5%	34.9	-13.0%	108.1	2.8%

- ❖ Year-end withholding receipts appear to be running above expectations, which would indicate that the Administration's estimate for stock options is reasonable.
- ❖ The estimated payments received in late December and early January have been weak, potentially indicating that capital gains were lower than expected. However, much of the revenue from capital gains is received with the final return filed in April, so the picture for capital gains is still unclear.

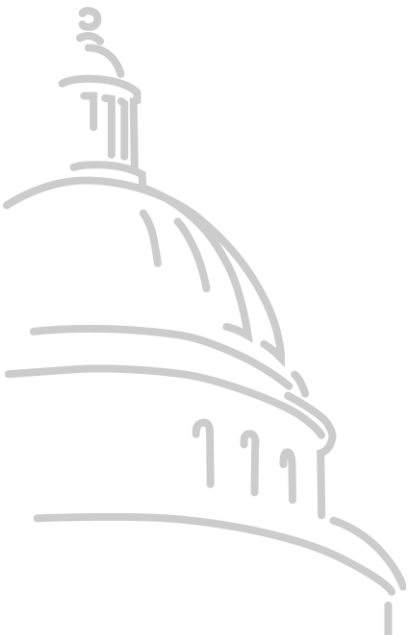


Options and Bonuses Concentrated in Six Industries

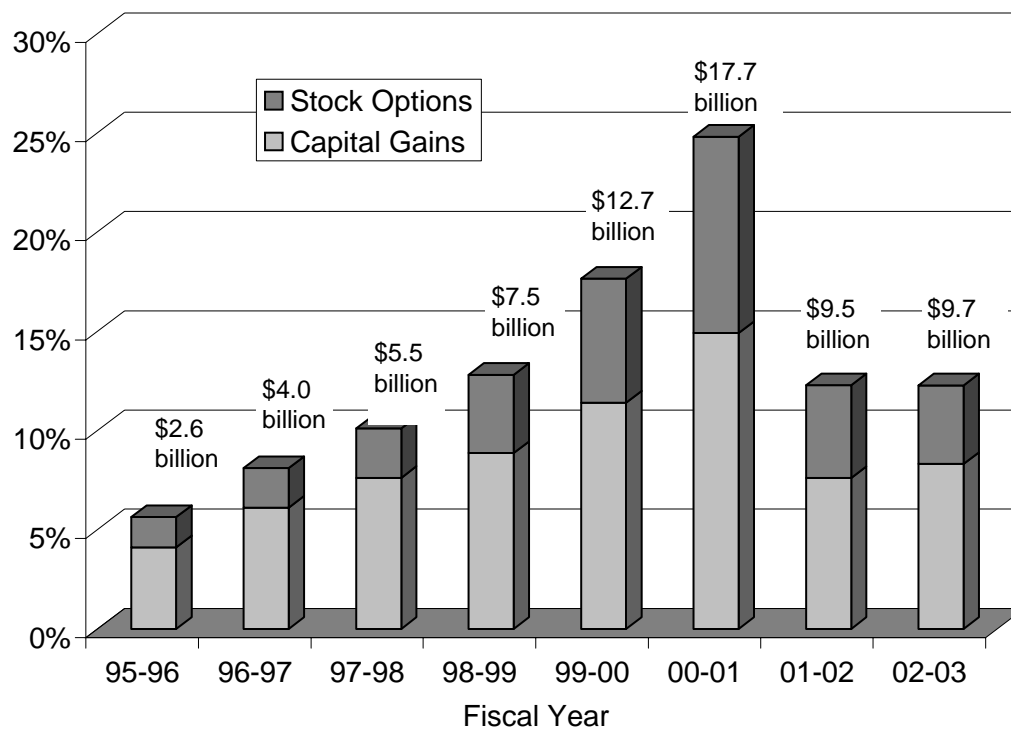
Wage and Salary Income and NASDAQ Growth



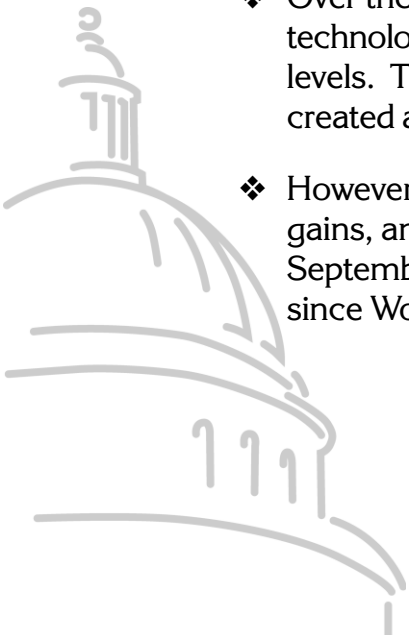
* Drugs, Computers, Electronic Components, Communication Equipment,
Finance Brokers, Computer Services



Capital Gains and Stock Options Revenue as a Percent of Total General Fund Revenue



- ❖ Over the last three years, the stock market, and particularly, the technology-driven NASDAQ index, soared to unprecedented levels. The resulting capital gains and stock option income created an unprecedented surge in state tax revenues.
- ❖ However, in 2001, the steep decline in the stock market, capital gains, and stock option income, coupled with the effects of September 11, produced the most precipitous decline in revenues since World War II.



Prudent Budgeting Practices

- ❖ One-time expenditures
- ❖ 2001 Budget Act reserve of \$2.6 billion
- ❖ Early actions to curb 2001-02 spending
 - ❖ Hiring freeze
 - ❖ State operations reductions
 - ❖ "November Revision" spending reductions

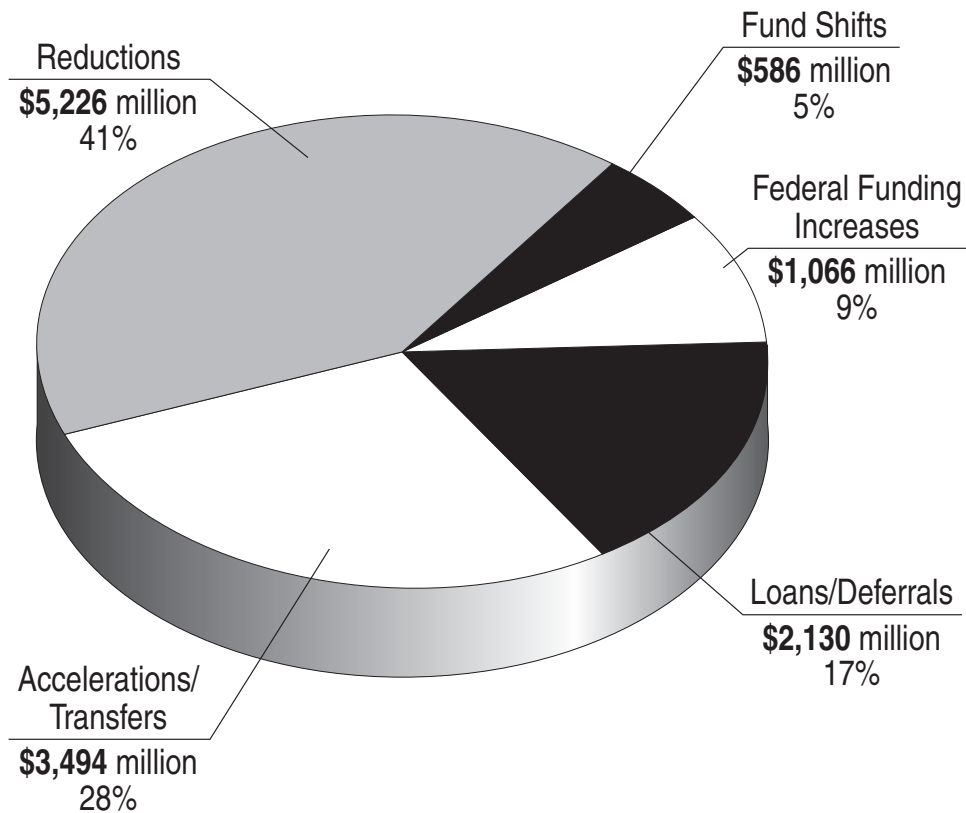


2002-03 Budget Principles

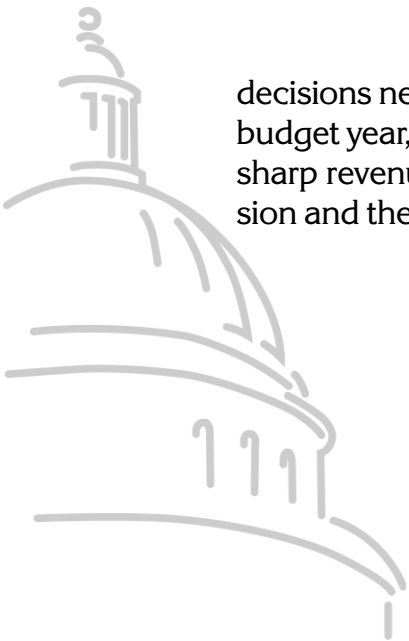
- ❖ Protect education
- ❖ Maintain public safety
- ❖ Protect children
- ❖ Shield local government
- ❖ Protect taxpayers



Bridging the Gap: \$12.5 Billion



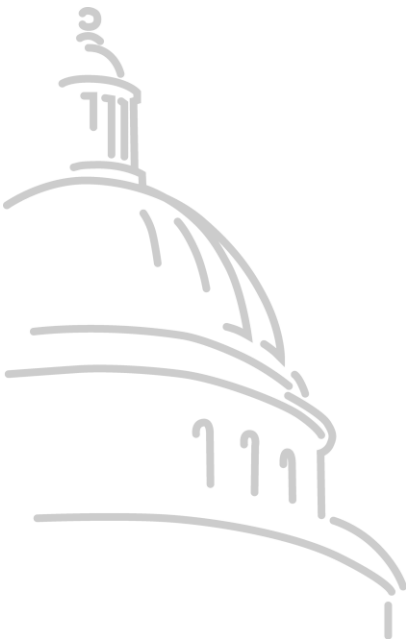
The Governor's 2002-03 Budget combines tough decisions necessary to reduce spending in the current year and budget year, and prudent fiscal measures designed to address a sharp revenue shortfall resulting from the effects of a national recession and the terrorist attacks of September 11.



Bridging the Gap

(Dollars in Millions)

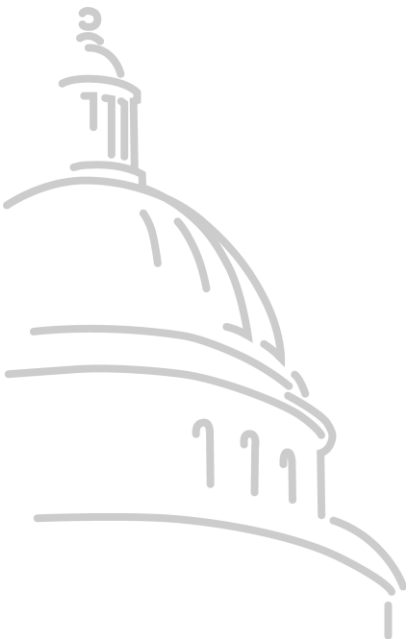
	<u>November Revision</u>	<u>Proposed Budget Year</u>
Reductions	\$2,449	\$2,777
Accelerations/Transfers	366	3,128
Loans/Deferrals		2,130
Federal Funding Increases		1,066
Fund Shifts	152	434
Total	<u><u>\$2,967</u></u>	<u><u>\$9,535</u></u>



Reductions

(Dollars in Millions)

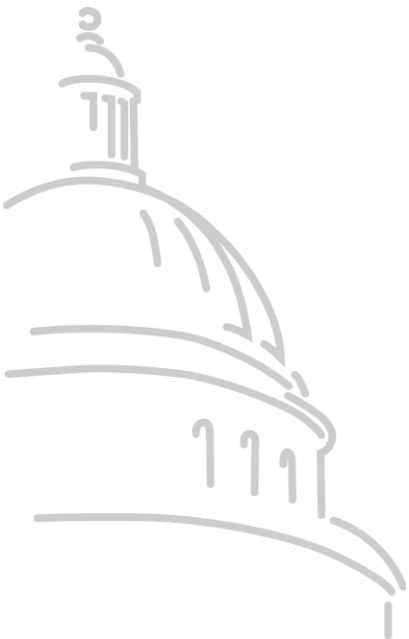
	<u>November Revision</u>	<u>Proposed Budget Year</u>
K-12 Education	\$1,207	\$487
Higher Education	118	451
Health	272	407
Human Services	139	742
Youth and Adult Corrections	9	17
Resources/Environmental Protection	222	35
Housing	3	38
Local Government		9
Capital Outlay Projects		92
Other Program Reductions	479	399
Litigation Reserve		100
Total	<u>\$2,449</u>	<u>\$2,777</u>



Accelerations/Transfers

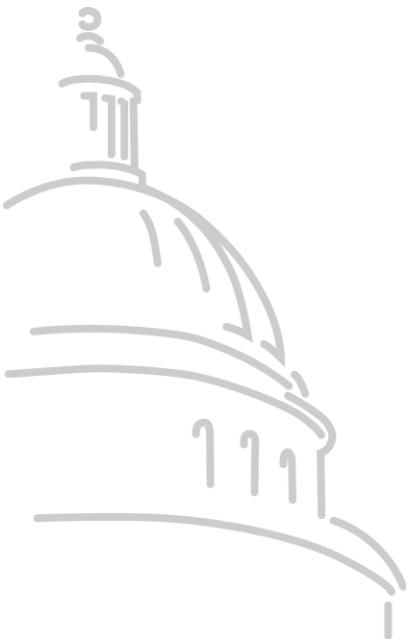
(Dollars in Millions)

	<u>November Revision</u>	<u>Proposed Budget Year</u>
Current Year transfers per November Spending Plan	365.6	
Securitize Tobacco Settlement Funds		2400
Transfer of Excess Balance from Certain Special Funds		201
Federal Tax Conformity		178
Other Revenue Accelerations		349
Total	<u>\$366</u>	<u>\$3,128</u>



Loans/Deferrals (\$2.130 billion)
(Dollars in Millions)

	<u>Proposed Budget Year</u>
Loan from Traffic Congestion Relief Fund	\$672
Loans from Various Special Funds	579
Payment Deferral/Benefit Improvement for STRS	508
Payment Deferral/Benefit Improvement for PERS	371
Total	<u>\$2,130</u>



Federal Funding Increases

(Dollars in Millions)

	<u>Proposed Budget Year</u>
Medi-Cal offset (FMAP)	\$400
Child Support System Penalty Relief	181
Federal Funding for Health and Human Services Programs	50
Federal Stamps for Post-August 22, 1996 Immigrants	35
Undocumented Felon Incarceration (SCAAP)	50
Security/Bioterrorism Funding	350
Total	<u>\$1,066</u>



Fund Shifts

(Dollars in Millions)

	<u>November Revision</u>	<u>Proposed Budget Year</u>
Shift per November Spending Revision	\$152	
Shift to Lease Revenue Bonds		\$160
Shift to General Obligation Bonds		7
Federal Special Education Grant		112
Shift to Other Special Funds		155
Total	<u>\$152</u>	<u>\$434</u>



General Fund Summary

2002-03 Governor's Budget General Fund Budget Summary (Dollars in Millions)

	<u>2001-02</u>	<u>2002-03</u>
Prior Year Balance	\$2,782	\$1,485
Revenues and Transfers	<u>\$77,083</u>	<u>\$79,305</u>
Total Resources Available	\$79,865	\$80,790
Expenditures	<u>\$78,380</u>	<u>\$78,806</u>
Fund Balance	\$1,485	\$1,984
Budget Reserves:		
Reserve for Liquidation of Encumbrances	\$1,473	\$1,473
Special Fund for Economic Uncertainties	\$12	\$511



2002-03 Budget: Major Reform Proposals

- ❖ Restructuring existing Instructional and Library Materials programs for K-12 schools to:
 - ❖ Align State funding with the standards adoption schedule.
 - ❖ Guarantee future funding increases to a total of \$600 million in 2006-07 for the proposed K-12 Instructional Materials Program.
 - ❖ Provide greater flexibility for the use of these funds by school districts.

- ❖ Expanding child care opportunities to:
 - ❖ Ensure more equitable access for the neediest families.
 - ❖ Promote greater cost-sharing for families through a graduated fee schedule.
 - ❖ Utilize existing resources more efficiently to serve more families and curb future program costs

- ❖ Improving California's workforce development system to:
 - ❖ Promote access and accountability
 - ❖ Eliminate program duplication
 - ❖ Achieve cost-efficiencies

